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CENTRAL INTELLIGENCE AGENCY
WASHINGTON, D.C. 20505

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CIA No. 9558
1 April 1975

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MEMORANDUM FOR: Mr. David Laux
Office of the Secretary
Office of National Security
Department of the Treasury

SUBJECT : The Indian Economy

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1. In response to your request of 21 March 1975
for briefing materials for Secretary Simon, we are
forwarding herewith, [redacted]

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[redacted] The Indian Economy: Outlook
and Potential. [redacted]

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2. Copies of The Indian Economy: Outlook and
Potential portion have been sent simultaneously to
Harvey Shapiro, Office of the Assistant Secretary for
International Affairs. Copies will be made available
to other requestors if deemed in the national interest.

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Chief
Developing Nations Division
Office of Economic Research

Attachments:
as stated.

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CENTRAL INTELLIGENCE AGENCY
WASHINGTON, D.C. 20505

CIA No. 9558
1 April 1975

MEMORANDUM FOR: Mr. Harvey Shapiro
Office of the Assistant Secretary
for International Affairs
Department of the Treasury

SUBJECT : The Indian Economy

1. I am forwarding herewith three copies of
The Indian Economy: Outlook and Potential, in
response to your request of early March. [REDACTED]

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2. Copies of this study are also being sent to
David Laux of the Office of National Security. Further
dissemination may be made if deemed in the national
interest.

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[REDACTED]
Chief
Developing Nations Division
Office of Economic Research

Attachments:
as stated.

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The Indian Economy: Outlook and Potential

1 April 1975

Office of Economic Research
South Asia Branch



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Summary

India has the potential for a much more productive economy. It has ample but underexploited land, water, minerals, technology, and human resources. The inexorable pressure of massive population growth makes continued economic growth mandatory. Politically oriented economic policies and a ponderous, pervasive bureaucracy limit rather than promote growth, however.

New Delhi has overemphasized industrial development at the expense of agriculture, which is key to Indian economic growth. Since 1971's record harvest, foodgrain production has fallen and grain imports have risen sharply. In industry, India's leadership restrains the development of the private sector and promotes public enterprise. Despite temporary relaxations of a few industrial controls, the basic path of Indian socialism is unchanged. In energy, shortages of domestically produced coal and the high price of imported oil have led to curtailed domestic consumption and higher trade deficits. Hopeful new oil discoveries will have little impact for several years. New Delhi continues to borrow heavily abroad and to seek rescheduling of its foreign debt.

The government is unlikely to change agricultural and industrial policy in a way to exploit India's potential for more rapid economic growth. Economic mismanagement will persist and economic growth will frequently be sacrificed for political goals. The government will continue to favor industry over agriculture and the public sector over the private. Agricultural performance will remain vulnerable to the vagaries of the monsoon, and foodgrain imports will probably remain large.

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I. Introduction

1. India is one of the poorest nations. Although its gross national product (GNP) is the tenth largest, its population is second only to that of China. In recent decades, the surging growth of India's population has often matched or exceeded economic growth. Net economic gains have remained meager despite billions of dollars in foreign aid. By the government's own reckoning, the living standard of 40% of its people approximates subsistence.

2. The Indian economy is basically rural-agrarian with a few large urban concentrations. More than 80% of the population lives in some half a million villages, engaged for the most part in subsistence agriculture. Yet, its urban population, which numbers more than 100 million, is industry-oriented, politically vocal, and dependent upon both the countryside and government-managed distribution networks for food supplies.

3. Indian economic policies have been essentially socialist. For nearly a quarter century the government has tried to develop an industrialized, self-sufficient economy through extensive economic controls, selective nationalization, and constraints on private industry. Unfortunately, the negative aspects of control have been emphasized, causing initiative to be more suppressed than promoted. Import growth has been constrained and industrial self-sufficiency enhanced, but at high cost. Indian export and industrial growth rates have

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significantly lagged those of other advanced LDC's. Natural resources remain underutilized.

II. Areas of Major Concern

A. Population

4. The rate of population growth increased sharply over most of the past two decades as reductions in the death rate outstripped reductions in the birth rate. Moreover, reduced child mortality through improved sanitation and medicine markedly increased the proportion of women of child-bearing age. The rate of growth apparently has leveled off.

5. There is considerable disagreement as to actual population size and growth rate. New Delhi sees its population reaching 600 million in 1975 and about 650 million by 1980. These estimates apparently are low; some international demographers would increase them by 30 and 50 million, respectively. Similarly, the Indian government estimates current population growth at 2 percent annually and projects a decline to 1.3 percent by 1985. Independent experts consider 2.2 percent a more realistic estimate of current growth, and foresee little decline over the next decade.

6. There is agreement, however, that two decades of government-sponsored birth control programs have had little effect; government support has declined. New Delhi estimates that births prevented ^{20 years of} through/government programs total less than the approximately 13 million added to India's population each year. A much stronger impact is desirable. Since peaking in

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FY 1972*, however, budgetary allocations for family planning have declined.

7. Some Indian planners consider existing family planning techniques inadequate to overcome the sociological and cultural obstacles encountered in India. Extreme poverty inhibits the use of birth control devices, however cheap, and perpetuates large families as insurance against the impact of sickness and old age. Illiteracy slows dissemination of information. Lack of employment opportunities encourage females to marry early. On the other hand, family planning goals are undermined by the central government's provision of tax, land, and welfare advantages to large families.

B. Agriculture

8. About three-quarters of India's population are farmers, most of whom produce just enough food for their families. India is one of the world's major producers of grains, peanuts, tea, jute, cotton, and sugar cane. Although most agricultural production goes to domestic consumption, agricultural commodities have contributed -- directly or indirectly -- to about 70 percent of export earnings in recent years.

9. Indian agriculture is critically dependent on the timing and intensity of the summer monsoon rains, which provide 75 percent of annual rainfall. There are two major growing seasons: the summer, or kharif season, associated with the summer monsoon and the winter, or rabi season. About 75 percent of annual

* The Indian fiscal year begins on 1 April of the stated year.

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agricultural production -- including two-thirds of total food-grains -- normally comes from the kharif season. Rice, the main kharif crop, is India's principal grain crop and is grown throughout the country under diverse weather and soil conditions. Wheat is the major rabi crop.

10. Indian agriculture has achieved impressive growth in grain production since independence. Gains have centered on wheat grown in the northwest where irrigation and increased use of fertilizers and pesticides successfully exploited the potential of the new high-yielding varieties (H.V.'s) and sharply increased yields. Limited application of new technology -- along with excellent weather conditions -- culminated in CY 1970/71* in a record grain harvest.

11. This achievement followed two decades in which increases averaged about 3.5 percent annually. During the first decade output grew 4.3 percent per year, largely due to expanded acreage. Growth slowed in the 1960s as the supply of new land decreased. Following a disastrous two-year drought in 1966-67, introduction of the new technology of the "Green Revolution" spurred production. This impetus contributed to the record CY 1970/71 harvest of 108 million tons which allowed the government to start building grain buffer stocks and helped feed the 10 million Bengali refugees during the fall of 1971. The successful harvests also prompted many Indian leaders -- prematurely -- to declare that foodgrain self-sufficiency had been achieved and no doubt contributed to

* Crop year 1 July-30 June.

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Mrs. Gandhi's decision to cancel PL-480 grain shipments late in 1971.

12. In the subsequent three years, production declined to an average of 102 million tons annually under the effects of adverse weather and ill-advised government controls on the grain trade. Grain imports, which declined steadily from a high of 10 million tons in 1965 to less than half a million tons in 1972, are again rising.

13. The division of responsibility for the formulation and implementation of agricultural policy between the central government and the states has reflected conflicting priorities and contributed to a disappointing performance. While the central government establishes national agricultural policies and budgets, three-quarters of total public expenditures on agriculture are controlled by the states. In the past, state and regional interests have usually taken precedence over national agricultural goals; the recent appointment of a skilled administrator and politician to head the Ministry of Agriculture, however, could help resolve such conflicts of interests.

14. Agricultural growth has also been hindered by inconsistent central government policies following an agricultural crisis, agriculture is given priority, but after a few good harvests, resources are reduced, agricultural programs are shunted aside, and long-term projects are postponed. Long-term production increases are targeted, but not vigorously pursued. Government interference in grain marketing through trade restrictions and price controls has inhibited producer incentives.

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15. Grain production in CY 1974/75 is low -- probably in the neighborhood of 96-99 million tons -- due to subnormal summer rains in many key areas. With little grain in reserve to offset the shortfall, massive foreign grain purchases had to be made to supplement domestically procured grain for the government's subsidized distribution system centered in urban areas. India's grain imports in CY 1974/75 are likely to total 7 million tons. Most has been procured through commercial channels. India has purchased 4.1 million tons from the US thereby becoming the largest customer for American wheat in this fiscal year. India is also receiving 800,000 tons of US wheat under PL-480. Sizable Indian imports will continue at least through the fall of 1975; more than a million tons of US wheat have already been purchased for shipment after 30 June.

16. New Delhi is likely to continue needing substantial foodgrain imports during the next three to five years. Consecutive monsoon failures, as occurred in the mid-1960s, could push grain import requirements to 10 million tons or more in any one year. A prolonged period of favorable weather like that of the late 1960s might give India a temporary respite from the burden of massive grain imports; but without a major reorientation of government agricultural policies, periods of improved foodgrain production and reduced imports are likely to last only until the next poor monsoon.

17. New Delhi will have to muster sustained efforts to accelerate growth in foodgrain production if self-sufficiency in

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foodgrains is to be achieved in the next decade. The potential for raising production is good considering that:

- India ranks among the world's lowest in fertilizer application;
- only 20 percent of cultivated land is irrigated;
- only 20 percent of cultivated land is under HYV grain, and less than one percent under high-quality HYVs.

18. Some specific areas where concerted efforts would be productive are:

- expansion of irrigation and the provision of more energy for irrigation pumps;
- increased production of fertilizer and pesticides;
- increased production of HYV seeds and improved quality standards;
- improved agricultural extension services; and,
- pricing policies aimed at providing incentives to farmers.

The recent series of shortfalls in production and the sharp increase in grain import prices are likely to spur "crash programs" in the coming months to increase supplies of agricultural inputs. Even if successful, their impact will be muted unless New Delhi removes grain trade restrictions that inhibit production incentives. New Delhi's concern over the effect of high food prices on the urban population, however, makes such moves unlikely.

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C. Industry

19. Priority has been given to the development of heavy industry with increased public participation since the beginning of India's Second Five-Year Plan in FY 1956. All expansion of basic heavy industry has been reserved exclusively for the public sector; expansion of the private sector has been controlled through restrictive licensing of industrial construction and imports, as well as price controls. The substitution of domestic production for imports has been central to India's development program. Private foreign investment has been restricted to those industries that require massive investment or extensive foreign technology. The principal export industries remained predominantly in private hands but have been taxed heavily to help finance public investment.

20. The government's strict control over industrial development has ensured basic imbalances in the industrial structure and a sluggish industrial growth. Industrial output grew by less than one percent in 1973 because of the cumulative impact of shortages and bottlenecks in key industries, such as steel, non-ferrous metals, coal and petroleum. To combat a 30 percent annual inflation the government undertook a restrictive monetary policy and curtailed public sector investment expenditures, thus prolonging industrial stagnation. Industrial output in 1974 grew about 2 percent, and the prospects for 1975 are not bright.

21. During 1974, there was some loosening of controls on industry. These moves have been ad hoc, however, and applied only

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only to the most severely affected industries. Similar liberalizations have been allowed in the last 20 years in order to relieve shortages but controls were always restored when conditions improved. There is no indication of any change in this policy. A rapidly growing trade deficit may force the government to tighten import controls further even before industrial growth increases.

22. Over the next 3 to 5 years, the outlook for industry is more hopeful, but many problems will persist. India has abundant mineral resources, a well developed transport network, and many trained people. Government policies and organizational problems will provide the main constraints. There are tentative indications that inflation is slackening, which may allow the government to loosen monetary policy by the last half of 1975. Increased agricultural production would stimulate industry by providing needed raw materials and increasing demand for manufactured goods. On the other hand, a reduction in the growth rate of imports will further curtail supplies of raw materials, capital goods, and spare parts. A tight rein will be kept on the private sector, permitting the public sector to continue expanding relative to the private sector. Management in the public sector, which has often been poor, should improve.

D. Energy Resources

23. India is relatively well-endowed with energy resources but exploitation has lagged. About half of the country's energy consumption comes from non-commercial fuels, such as firewood and dung. Of the commercial fuels, coal accounts for about 60 percent

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of energy consumption; petroleum for 25 percent, and hydroelectric
and nuclear power for 15 percent.

24. Coal consumption is covered exclusively by domestic
production. Coal reserves are extensive, exceeding 100 billion
tons, some 1,300 times current annual production. In contrast,
proved petroleum reserves (excluding recent offshore discoveries)
of 100 million tons are equivalent to only 14 times current annual
production.

25. Petroleum production of about seven million tons a year
covered nearly one-third of petroleum consumption in FY 1973 and
FY 1974. The financial strain of the sharp increase in petroleum
prices prompted New Delhi to impose a \$1.3 billion ceiling on
petroleum imports. This ceiling will hold imports at 17 million
tons, nearly the same as last year, but about twice the cost.

Petroleum Imports, Fiscal Years 1972-1974

<u>Million Metric Tons</u>				<u>Import Cost (Million US\$)</u>
<u>Fiscal Year</u>	<u>Crude</u>	<u>Products</u>	<u>Total</u>	
1972	12.3	3.2	15.5	265
1973	13.4	3.8	17.2	700
1974*	13.5	3.5	17.0	1,300-1,400

* Estimated.

26. The energy gap created by curtailment of petroleum imports
cannot quickly be covered by conservation, changeovers to alter-
nate energy sources, or increased domestic production. Limited
rationing of industry's eighty-five percent share of petroleum

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consumption immediately exacerbated power shortages that had long constrained industrial growth. Consumption by households is predominantly for cooking, very little for transportation. Nor does conversion to coal consumption offer ready relief; coal output continues to lag both production targets and demand, although New Delhi in early 1973 nationalized the industry and began promoting industrial use of coal rather than oil. Petroleum production has been static in recent years. Output from currently producing fields may soon decline. Any substantial increase in domestic crude production is contingent upon the discovery and development of new fields.

27. Offshore oil exploration shows considerable promise, but will not make a significant contribution to energy resources for several years. Tentative evaluation of three successful test wells in the Bombay High indicates that field may have an ultimate potential of 10 million tons a year. A recent Indian estimate claims that output could be reached by 1980. One-fourth as much is a more realistic projection in view of the worldwide shortage of drilling crews, rigs and associated equipment. Domestic production of hydroelectric and nuclear power, as well as coal, can be greatly expanded, but their development will continue to be slow and costly.

28. Because petroleum imports are a major drain on India's finances, their reduction is a prime goal, but an elusive one. Considering all the limitations on growth of domestic energy production, it is unlikely that growth in petroleum consumption

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can be reduced by more than half without worsening India's chronic energy shortage. If annual petroleum consumption growth can be reduced to 5 percent and domestic oil production increased to 10 million tons annually by 1980 -- very optimistic assumptions -- India will nonetheless have to maintain the current ratio of imports to consumption at about 2:3 through 1980.

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B. International Trade and Payments

29. New Delhi controls all import expenditures through a complicated licensing system requiring that imports be both vital to the economy and unavailable domestically; comparative costs are not considered. Principal imports are handled exclusively by state corporations. The import control system has produced a lumbering, corrupt bureaucracy, excessive import delays, elimination of foreign competition, restriction of competition among domestic firms, and overconstruction of industrial capacity.

30. Nonetheless, New Delhi has been generally successful in achieving the major goals of its import controls. Dependence on imports has declined significantly; the import structure has shifted from finished manufactures to raw materials and components; and in many important areas, domestic production has effectively substituted for imports. For these gains, India has paid dearly in terms of industrial growth impeded by import shortages, export growth retarded as sheltered domestic industry became less competitive, essential imports postponed while world prices rose, and trade and market channels dislocated through smuggling and black-marketeering. The controls and associated diseconomies are likely to continue.

31. Since FY 1972, when India ran its first trade surplus in 22 years, the balance of trade has deteriorated dramatically, from a small surplus to massive deficits in FY 1973 and FY 1974. Over that period, a 45 percent growth in exports was dwarfed by a 115 percent growth in imports.

32. India's import bill grew almost 50% in FY 1974 as world market prices soared and poor grain harvests increased grain import requirements. Outlays on three of India's most essential imports, petroleum, foodgrains, and fertilizer, produced the entire estimated increase. Expenditures on other imports essential to industrial production were held at FY 1973 levels, but quantities were generally lower. Military imports [REDACTED]

[REDACTED] are estimated at about \$145 million in FY 1974. In FY 1975, military imports are expected to rise to between \$180 million and \$260 million.

	Million US\$		
	<u>FY 1973</u>	<u>FY 1974*</u>	<u>Increase*</u>
Balance of Trade	- 540	-1,600	-1,060
Exports	3,110	3,800	690
Imports	3,650	5,400	1,750
Selected Items:			
Foodgrains	600	1,300	700
Petroleum	700	1,300	600
Fertilizers	280	670	420

* Estimated.

33. Export growth in FY 1974 was broad-based and resulted from a variety of factors. Price effects of global inflation and shortages were strongly reflected in increased export earnings of jute manufactures, iron ore, cotton textiles, tea, tobacco and sugar. Sugar sales rose spectacularly to an estimated \$300 million from \$55 million in FY 1973. Declining domestic demand, progressive devaluations of the rupee -- which is tied

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to the pound sterling -- and positive steps by New Delhi to promote exports were also important, notably the linking of import privileges for both traditional and developing export industries to export performance. Other measures included selective reductions in export duties, subsidy increases and concessional freight rates.

34. Private capital flows play a minor role in India's balance of payments. Direct foreign investment and reinvested earnings are largely offset by repatriation of profits and disinvestment so that the net flow rarely exceeds \$100 million a year in either direction. The government remains committed to reducing the concentration of economic power and dependence on foreign firms; private foreign investment therefore interests New Delhi only if it earns foreign exchange through exports, saves foreign exchange through import substitution, or transfers advanced technology to India. The interest of potential foreign investors, in turn, is cooled by New Delhi's limitations on foreign equity -- generally 40 percent or less -- and by the blanket of state controls on supplies, trade, personnel and expansion that severely curb management's flexibility. New Delhi's policy of progressively tightening controls on industry must be reversed if private foreign investment is to grow.

35. The deterioration in the trade balance over the past two years caused a massive increase in foreign indebtedness despite increased foreign aid. India obtained nearly \$700 million from the IMF, rescheduled \$200 million in debts, and obtained the

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following estimated amounts of aid:

	<u>Million US \$</u>	
	<u>FY 1973</u>	<u>FY 1974</u>
Disbursements from consortium countries	1,100	1,300
Soviet wheat loan	230	170
Iranian and Iraqi oil offsets	--	200
Other	50	50
TOTAL	<u>1,380</u>	<u>1,720</u>

The US has made no new aid commitment since December 1971, but during FY 1974 rescheduled \$45 million in debts, provided \$78 million worth of grains under PL-480, and donated \$6 million worth of commodities. The US has recently agreed to ship \$128 million worth of wheat under PL-480 to arrive in FY 1975.

36. The same level of aid will be more difficult to obtain in FY 1975. Although the prospects are good for oil credits from Iran, Iraq, and the UAE, the USSR and Eastern Europe are unlikely to increase aid significantly, and they have remained unresponsive to Indian efforts to soften terms or reschedule debts. Most important, consortium aid may decline because member countries have their own balance of payments problems. Food aid could vary widely, depending on India's annual monsoon and world-wide grain harvests, especially that of the US. New Delhi, therefore, will have to take some combination of the following steps: dip into its foreign exchange reserves (\$1.3 billion at the turn of the year); further increase IMF borrowings; press for debt rescheduling; or, as a last resort, further curtail imports.

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37. Indian can be expected to press vigorously for further debt rescheduling as its debt service payments grow. Repayments on development loans extended through 31 March 1974 now approach \$700 million annually, as shown below:

	Million US\$				
	<u>FY 1974</u>	<u>FY 1975</u>	<u>FY 1976</u>	<u>FY 1977</u>	<u>FY 1978</u>
TOTAL	<u>674</u>	<u>687</u>	<u>682</u>	<u>700</u>	<u>697</u>
Consortium members	525	548	552	579	593
USSR and Eastern Europe	68	69	68	66	60
Others	81	70	62	55	44

New loan commitments totaling about \$1.6 billion during FY 1974 plus expected future loans will probably increase actual FY 1978 repayments to around \$900 million. In addition, repayment for much of India's 1974 borrowing from the IMF will also fall due during this period. Thus, in the absence of some fundamental policy changes, India's ability to meet payments will continue to hinge largely upon new loans and repeated reschedulings of payments. Over the longer term, improved production of foodgrains and energy are critical to the reduction of India's large trade deficits.

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Outlook

38. The Indian economy remains tightly bound to the performance of the monsoon. The bond could be loosened -- but not severed -- by a change in economic policy, to channel greater investment into agriculture.* The government probably will not take that step now because of the need to revise allocations for energy. A large increase in foreign and domestic private investment would be necessary to stimulate growth in both agriculture and industry, eliminate restrictive shortages, and keep abreast of the needs of the ever-growing population. India lacks the credit and the domestic growth to support such an outlay. Although keenly aware of their many economic problems, Indian leaders are satisfied that their handling has been basically correct. Moreover, it is unlikely that even a drastic worsening of India's economic plight would shake that confidence.

39. No lasting improvement in Indian living standards is foreseen so long as New Delhi (1) emphasizes income redistribution instead of growth, and (2) uses tighter control of transactions rather than market incentives as the basic prescription for economic ills. Prospective production increases will barely exceed population growth.

40. The short-term outlook for the Indian economy is darker than usual because three successive sub-par harvests have virtually eliminated both government and private grain stocks. A fourth

* For discussions of the potential impact of selected changes in agricultural policy, see the Annex to this paper.

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poor monsoon could bring widespread hunger and further depress an already distressed economy. Inadequate rainfall would increase the need for imports of foodgrains and petroleum (the latter to offset shortages of hydroelectric power). Shortages of agricultural raw materials and electric power would at the same time curtail India's ability to produce for the export market. The US and others would be pressed to step-up foodgrain shipments, increase grants and loans, and further reschedule debt payments.

41. A good monsoon could temporarily lift the Indian economy from the stagnation of the past two years. Foodgrain imports would decline. A widespread pick-up in economic activity would increase the need for petroleum to meet a rising demand for energy, and the ability to finance imports would be enhanced. Two or three successive years of good monsoon would be required, however, to rebuild grain stocks sufficiently to buffer the economy against the effects of adverse weather. The odds against such a run of good weather are formidable.

42. Unless fundamental changes occur in government policies, the Indian economy will continue to stagger along, sustained by the uncertain benevolence of the monsoons and propped up by the more reliable consortium dole.

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Potential Impact of Selected
Changes in Agricultural Policy

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A. Higher Taxes on Agricultural Land and Income

India admittedly is short of investment funds to promote exploitation of its resources. It has borrowed heavily abroad to support domestic development, yet has foregone substantial domestic revenues by permitting agriculture, which generates nearly half of national income, to remain lightly taxed. Furthermore, the share of combined state and central government revenues generated by agricultural taxes has been declining. Land taxes accounted for 7.5% of tax revenues in FY 1951, but only 2% in FY 1973. Over the same period, the percentage of revenues derived from taxes on agricultural income slipped from 0.7% to 0.2%.

The constitution gives the states sole tax authority over agricultural land and income. All states exercise their prerogative to assess land, but few vigorously pursue land revenue. Some assessment rates and absolute assessments have remained unchanged for half a century. Only 9 of the 21 states tax agricultural income, with coverage aimed at plantation agriculture.

Indian economists see considerable revenue potential in raising agricultural taxes and little danger of dampening production incentives. Increased agricultural taxation would be aimed only at farmers with substantial holdings (nearly half of India's cultivated land is owned by about 10% of its farmers) or other wealthy people who use farm operations as tax shelters. If revenues generated from agricultural taxation were re-invested in agriculture, production could be substantially enhanced.

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Laxity in agricultural taxation has been widely criticized in India. Commerce and industry are critical of the inequity of their tax burdens. Government administrators complain of their lack of funds and the inflationary impact of growing budget deficits. Development planners are hampered in their efforts to generate funds for investment.

National commissions recently have been focal points of tax reform discussions. In 1971, the Wanchoo Committee charged that tax exemptions granted to agricultural incomes were being used to shelter non-agricultural income. The Committee's recommendation that income from all sources be equally taxed has not been adopted. In 1972, the Raj Committee recommended that agricultural income ~~and~~ be added to non-agricultural income for tax purposes. This has not been adopted.

The Raj Committee also recommended an Agricultural Holding Tax (AHT) that would replace extant land taxes. The AHT would promote effective utilization of agricultural land by taxing its income generating potential. It would also be directed at family rather than individual landholdings in order to cover a popular loophole. It constitutes an effort to progressively tax agricultural income via the widely accepted land tax mechanism. The Committee estimated that even its most modest application could increase state and central revenues by 3 percent and that this could be substantially increased in successive steps.

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Central government efforts to persuade states to adopt AHT have been unsuccessful. New Delhi's recent Economic Survey noted:

"...overall progress in this area [agricultural taxation] is still insignificant. No state has so far shown any initiative to implement the report of the Raj Committee. . . ."

Mrs. Gandhi's Congress Party with its two-thirds parliamentary majority and control over half the state legislatures has sufficient power to change the constitution and has frequently done so. She is most unlikely to press changes in agricultural taxation, however, because agricultural interests are the principal support of her party. The promotion of even a modest increase in agricultural taxation can be politically risky.

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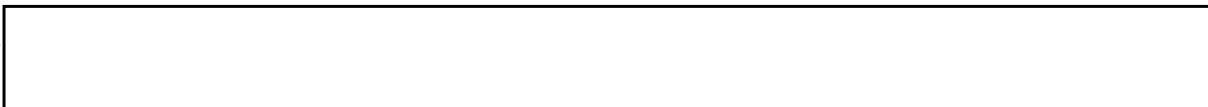
B. Increased and Improved Irrigation

India has good potential for expanded irrigation. Little more than 20 percent of cultivated land is now irrigated; Indian experts believe the volume can economically be doubled. Moreover, the quality of irrigation is low. On only a fraction of the fields is water control and supply sufficient for effective use of HYV grain or to support double cropping.

Production gains from irrigation are difficult to project because of wide variation in quality and because good irrigation permits more effective use of agricultural technology -- HYVs, fertilizer and insecticides -- that has a synergistic effect on yields.* For all of India, yields from irrigated land are about double those from unirrigated land. Potential gains are much greater, however. An additional advantage of irrigation is that it reduces fluctuations in production, thereby decreasing hardships, stabilizing prices and facilitating planning.

Irrigation projects range widely in cost, returns, construction periods and effective life. The vast majority, however, are economic only when costs and benefits are shared by many; irrigation, therefore, is usually a government undertaking.

India's Fifth Five-Year Plan allocates 20 percent of public sector investment to agriculture, including 7.2 percent for irrigation and flood control. The latter percentage is somewhat smaller than those in earlier plans. Under the plan, about \$3 billion



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would be invested in large-scale irrigation projects that would bring water to 15 million acres. Nearly \$5 billion, from both public and private funds, is to go to small-scale projects that would affect 22 million acres.

Money is the major constraint on irrigation development. A shift in priorities to give agriculture a share of development funds more in line with the role in the economy would help. Shares of Public Sector Investment allocated to agriculture and irrigation in the Fifth Five Year Plan are 20 and 7.2 percent, respectively.

Another serious problem is that the states have exclusive constitutional authority over rivers. The central government can exercise only limited influence toward resolution of interstate disputes involving riparian rights. Such disputes are holding up more than a hundred irrigation projects in 13 states.

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C. Abandonment of the Foodgrain Procurement System

The government influences the supply and price of grain through its system for procurement and distribution. The Food Corporation of India, established in 1967, purchases large quantities of grain each year at a government-set procurement price. Domestically procured grain, supplemented as necessary with imported grain, is distributed in scarcity areas through fair price shops -- small private stores licensed to sell at fixed "issue" prices. Consumers with identity cards purchase limited quantities of grain from the fair price shops, while supplementing their rations through purchases on the open market.

The procurement system worked well through 1971. Poor harvests then caused grain procurement to fall in each of the next three years despite extreme efforts by New Delhi. By December 1972 buffer stocks were almost exhausted and grain imports began rising sharply. In March 1973, New Delhi decided that wheat procurement could be maximized only through control of wheat movements from surplus to deficit areas, and nationalized the wholesale wheat trade. Procurement continued to fall, and New Delhi was forced to denationalize the wheat trade in March 1974. Plans for nationalizing the rice trade also were abandoned.

Under the scheme introduced following the 1974 denationalization, wheat wholesalers in the five surplus wheat-producing states were required to sell half of their wheat purchases to the government at the procurement price. In an attempt to avoid the 1973 fiasco,

wheat procurement prices were raised 38%; most of the increase was passed on by boosting the issue price 35%. Wheat procurement, however, was disastrous, primarily because the wheat harvest declined again. Market prices soared to double the new procurement prices, augmenting incentives to circumvent the system.

In March 1975, New Delhi again drastically shifted its wheat procurement policy. It abandoned the 50% levy on private wholesalers, but reinstated the ban on private interstate wheat movements. Thus, New Delhi moved back toward monopoly procurement. The procurement price was not raised, so that issue prices could be kept stable. To control blackmarketeering, harsher penalties for hoarders and smugglers were instituted.

Evaluation of the Foodgrain Procurement System

New Delhi has intervened in the grain market mainly to assure supplies of cheap grain to urban areas, thereby placating the most politically volatile groups. Despite government pronouncements to the contrary, the procurement system is only secondarily used to support grain prices and is not comparable to US farm support or parity programs.

The procurement system is designed to acquire large quantities from good harvests and small quantities from poor harvests. It works well if buffer stocks or cheap grain imports are available to carry over lean harvest periods. Grain imports, however, are no longer cheap, and buffer stocks are precariously low. In this situation, New Delhi feels pressed to step up procurement during poor harvests in order to meet an anticipated larger demand on

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on public distribution without relying completely on costly imports. Intensified government procurement efforts in a shortage situation raise market prices precipitously, but previously announced procurement prices are nonetheless retained and procurement falls. The higher the market price relative to the procurement price, the greater the incentive for circumventing any system of compulsory procurement. And in India, circumvention of government controls through falsification, smuggling, and bribery is commonplace.

The principal determinant of procurement success is harvest size, or more specifically, the marketable surplus. The drastic changes in procurement policy during the last several years never altered this relationship. The differential between a grain's free market price and the procurement price also affects procurement, but to a lesser degree. As the differential widens, procurement is adversely affected. The pull of a large differential remains strong even when private grain movement is banned, presumably because of ample opportunity to avoid the ban.

Higher procurement prices may stimulate production, but there is no statistical evidence to support this contention. In the short term, raising procurement prices in a sellers' market also raises free market prices leaving the shares^{of}/government and private buyers virtually unchanged. In the longer term, higher procurement and free market prices should stimulate production if their effects are not offset by increasing costs and uncertainties arising from frequent changes in government policy. In that

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regard, the Minister of State for Punjab Agriculture recently charged that New Delhi's repeated changes in wheat policy had caused Punjabi farmers to shift 5 million acres from wheat to gram and barley, which yield less than wheat but are free of controls.

In setting procurement prices the government must weigh several factors. High procurement prices are favored in order to:

- * promote procurement (but this does not always work);
- * stimulate grain production (under certain questionable assumptions); and
- * placate grain surplus states..

Low procurement prices are favored in order to:

- * reduce the cost of procurement;
- * support low issue prices, thereby pacifying the urban population;
- * avoid inflationary pressures; and
- * placate grain deficit states.

This analysis suggests that the procurement system is a poor mechanism for stimulating grain production and, as employed, has suppressed it. Moreover, since it can stimulate production only through higher prices, that use conflicts with the system's major purpose, namely, providing low cost grain to urban consumers. New Delhi also views it as a means to indirectly tax agricultural incomes, which the constitution precludes the central government from doing directly. For these reasons, New Delhi has been reluctant to increase procurement prices.

Grain production can be more effectively stimulated by a return to a free market than by manipulation of procurement price under current circumstances, i.e., low buffer stocks and high import prices. These same circumstances, coupled with New Delhi's poor financial condition, make abandonment of its procurement/distribution system politically impossible. Although New Delhi is finding it increasingly difficult to finance its large welfare system, it is a political necessity, at least until harvests improve. Poor crops have increased dependency on government grain supplies. Concurrently, inflation makes it advisable that New Delhi hold the line on food prices. New Delhi cannot easily abandon its present role in grain distribution unless grain again becomes plentiful.

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D. Increased Production and Consumption of Fertilizer

Increased fertilizer use can substantially boost agricultural production. Under average Indian conditions the application of a ton of fertilizer nutrients can increase grain yields by 5 to 10 tons, and Indian fertilizer use is among the world's lowest. Inadequate growth of domestic fertilizer capacity and poor utilization of existing capacity have become increasingly troublesome as international shortages and high prices constrained fertilizer imports.

Domestic fertilizer capacity, production, and consumption increased rapidly over the past two decades, particularly since the advent of the "Green Revolution" in the late 1960s. Yet, imports have had to provide nearly half of the fertilizer consumed in recent years, as construction problems and the usual bureaucratic delays kept the industry's growth below plan targets and short of rapidly growing demand. Over the past three years, consumption growth has been slowed by inadequate supplies.

India: Fertilizer Consumption, Production, and Capacity
Selected Years 1955-75
(in nutrient tons)

<u>Year*</u>	<u>Estimated Consumption</u>	<u>Domestic Production</u>	<u>Estimated Capacity (Beginning of Year)</u>
1955	138,800	89,200	206,000
1960	293,900	165,700	249,000
1965	652,600	356,700	744,000
1970	2,177,300	1,060,600	1,600,000
1971	2,621,800	1,239,600	1,720,000
1972	2,698,800	1,384,400	1,975,000
1973	2,783,000	1,374,100	1,975,000
1974	2,800,000	1,500,000**	2,528,000
1975	--	--	3,350,000

* Fiscal year beginning on 1 April of the year specified.

** Estimated.

India's Fifth Five-Year Plan calls for the expansion of fertilizer capacity to 8.7 million tons. This target appears grossly over-optimistic in view of past performance. New capacity now under construction totals only 1.9 million tons and another 2.9 million tons of capacity are still on the drawing board. By 1980 only about 50% of the planned new capacity is likely to be installed, but even this achievement would double capacity to 6.25 million tons. Construction will require substantial foreign funds and technical assistance.

Operational performance of fertilizer plants has been mixed, with capacity utilization for the entire industry ranging between 60-70% in recent years. The private sector has operated more efficiently than the public sector. Some new plants have had difficulty getting into production. Two large public sector nitrogen plants at Durgapur and Cochin were completed in late 1971, but design defects and faulty equipment kept them out of operation until FY 1973, when they produced at less than 10% of capacity. [redacted] production losses in FY 1973 -- excluding the Durgapur and Cochin plants -- amounted to 335,000 tons, due primarily to power shortages, maintenance problems, feedstock shortages, and labor disputes. These problems persist. Production in the first three quarters of FY 1974 was only slightly better than during the same period of the preceding year. Characteristically, the Indians attribute their production problems to the high prices of imported oil and rockphosphate,

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ignoring years of stalled domestic oil exploration and floundering production of rockphosphate from the extensive deposits in Rajasthan.

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